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No. 88-1482

IN THE

Supreme Court of the United States

OCTOBER TERM 1988

THE CORPORATION COMMISSION
OF THE STATE OF OKLAHOMA,

Petitioner,

v.

ANR PIPELINE COMPANY, ET AL.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITIONER'S SUPPLEMENTAL BRIEF

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QUESTION PRESENTED

(same as in certiorari petition)

Is the State of Oklahoma pre-empted under the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978 from exercising regulatory authority over interstate pipelines pursuant to OKLA. STAT. tit. 52 §240?

PARTIES

Petitioner:

The Corporation Commission of the State of Oklahoma

Respondents:

ANR Pipeline Company
Colorado Interstate Gas Company
Columbia Gas Transmission Corp.
KN Energy, Inc.
Mississippi River Transmission Corp.
Natural Gas Pipeline Company of America
Tennessee Gas Pipeline Co.
Williams Natural Gas Co.
El Paso Natural Gas Company
Western Gas Interstate Company
Southern Natural Gas Company

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PETITIONER'S SUPPLEMENTAL BRIEF

Petitioner Corporation Commission of the State of Oklahoma ("Corporation Commission") submits this Supplemental Brief under S.Ct.R. 22.6 to draw attention to a new case—this Court's decision in *Northwest Central Pipeline Corp. v. State Corporation Commission of Kansas,* No. 86-1856, 57 U.S.L.W. 4302 (U.S. Mar. 6, 1989)—which was not available when the Corporation Commission filed for certiorari review of the Tenth Circuit's decision in *ANR Pipeline Co. v. Corporation Commission,* 860 F.2d 1571 (10th Cir. 1988). The *Northwest Central*

case was issued March 6, 1989, when the Corporation Commission's certiorari petition was being printed for filing on its due date of March 9, 1989. This Supplemental Brief discusses only the *Northwest Central* case.

SUPPLEMENTAL STATEMENT OF REASON FOR GRANTING THE WRIT

As more particularly stated in the Corporation Commission's certiorari petition, the Tenth Circuit invalidated on pre-emption grounds an oil and gas production regulation adopted by the State of Oklahoma. The Tenth Circuit wrongly declined to analyze Rule 1-305 as a production regulation under 52 O.S. § 239 (a production statute) as well as 52 O.S. § 240. *See ANR Pipeline Co.,* 860 F.2d at 1582 n.4. In *Northwest Central,* this Court approved a state regulation affecting the interstate purchasers because that regulation was a production regulation. The Tenth Circuit rendered its decision in this case without the benefit of *Northwest Central,* which warrants an opposite result to what the Tenth Circuit held. The Corporation Commission thus asks this Court for alternative relief, as follows:

(1) grant certiorari summarily at this juncture and remand to the Tenth Circuit for a reconsideration of its decision in light of this Court's intervening decision in *Northwest Central,* or

(2) grant certiorari straightaway to correct the Tenth Circuit's decision in this case, all for the reasons

stated in the Corporation Commission's certiorari petition and in this Supplemental Brief.

This Court's early cases concerning pre-emption clearly establish that although federal regulation of interstate gas sales existed, states nonetheless retained the power to control excessive production—an essential power to prevent waste, protect the correlative property rights of mineral owners, and assure the public interest in maintaining adequate gas supplies.

Today, a unique and new factual situation concerning waste confronts producing states like Oklahoma. Production controls no longer focus only on waste from overproduction. Today, subterranean waste and issues of public safety resulting from *under-production* are key concerns. This new concern stems from two factors. First, nationwide gas demand has plummeted in recent years. For example, in a relatively short period of time, nationwide consumptive demand fell from 22 tcf to 16 tcf. Second, once robust gas pools began to deplete. In these circumstances, hardship and distressed wells present acute concerns. Unless these wells continuously produce, they may be completely lost, leaving pockets of unrecoverable reserves; or they may become unstable, posing a public safety threat. Thus, the modern conception of production controls includes in addition to production restraints, production mandates.

Modern production regulations must frequently be geared towards sustaining production in some wells, while restraining production in other wells. This Court recognized in *Northwest Central* that a state may have a

legitimate interest in not only restricting production, but in encouraging production by inducing purchasers to take gas. In *Northwest Central,* this Court upheld a ratable production regulation against a pre-emption challenge where "the purpose of the new regulation was to 'instill the incentive for the purchasers and the producers to run more gas out of the field . . . '." No. 86-1856, slip op. at 9, 57 U.S.L.W. at 4305. Interstate pipelines had been using the Hugoton field to store low cost gas. Because this was having an adverse effect on Kansas producers, the Kansas Corporation Commission amended its proration rules to provide that if a producer became underproduced from the interstate pipeline failing to purchase the gas, then the producer's underage would be cancelled under certain circumstances. The rule was popularly called a "use it or lose it" measure. The effect was to require the interstate pipelines to purchase from the Hugoton field, or lose their ability to purchase that gas at a later date. *See* slip op. at 9, 57 U.S.L.W. at 4305.

Because the Kansas Corporation Commission's regulation dealt with areas of legitimate state concern, this Court upheld the regulation, even though the regulation influenced interstate purchasing practices. Oklahoma's Rule 1-305 is constitutionally valid by that same measure. Rule 1-305 contains vertical production mandates that minimize curtailments from prioritized wells and also horizontally divides actual market demand fairly and ratably among all producers. Thus, Oklahoma regulates production both to prevent waste when low market demand shuts in marginal wells, and to assure that produc-

tion is shared fairly among those having a right to produce. Each of these functions is a legitimate state concern involving prevention of waste, protection of correlative rights, and the protection of public safety. These state concerns are addressed by Rule 1-305 which is a *production* regulation and involves purchasers only as a necessary and limited means of allocating production. The Tenth Circuit failed to analyze Oklahoma's regulation in the *Northwest Central* sense and thus wrongly invalidated it.

A. RULE 1-305 DOES NOT REGULATE IN A FIELD OCCUPIED BY CONGRESS.

This Court reaffirmed in *Northwest Central* that states are entitled to govern production of natural resources by prorating production among the various wells operating in a field. *Northwest Central,* slip op. at 15-16, 57 U.S.L.W. at 4307. The power retained by the states is the power to require "proration of gas production in aid of conservation and the protection of correlative rights." *Id.*

In light of these state rights, this Court specifically approved the operation of the Kansas Corporation Commission rule in prodding interstate pipelines to actually purchase prorated shares of production. This Court stated:

> It would be strange indeed to hold that Congress intended to allow the States to take measures to prorate production and settle allowables in furtherance of legitimate conservation goals and in order to protect property rights, but that—

> because enforcement might have some effect on interstate rates—it did not intend that the States be able to enforce these measures by encouraging actual production of allowables.

Northwest Central, slip op. at 17, 57 U.S.L.W. at 4307.

This Court indicated that states are pre-empted from directly regulating interstate pipelines in such a way as to affect their cost structures. *Id.* However, to find field pre-emption simply because "purchasers' costs and hence rates might be affected would be largely to nullify" the states' control over production. *Id.,* slip op. at 18, 57 U.S.L.W. at 4308.

The case against pre-emption is even more compelling here. Unlike the Kansas Corporation Commission regulation, the ratability provision of Oklahoma's Rule 1-305 is price neutral. The long term contracts involved in the Kansas Hugoton field did not generally contain take-or-pay provisions. *Northwest Central,* slip op. at 6, 57 U.S.L.W. at 4304. But industry practice of recent times is for take-or-pay provisions to appear in contracts affected by regulations like Rule 1-305. *See id.; Transcontinental Gas Pipeline Corp. v. State Oil & Gas Board of Mississippi,* 474 U.S. 409, 412 (1986) (*Transco*). Because ratable takes only incidentally affect the mix of a purchaser's purchases, and because the purchaser must anyway take or pay for the same contractually predetermined volumes, the ratability feature of Rule 1-305 does not impermissibly affect costs. Actually, Rule 1-305 is cost-neutral.

Unlike Mississippi's ratability rule in *Transco,* Rule 1-305 does not require the interstate purchaser to purchase

one molecule more gas than such purchaser would otherwise purchase, or otherwise increase its contractual obligations. The rule pre-empted in *Transco* required the interstate purchaser to take gas even from parties *not* under contract with the purchaser. However, Rule 1-305 does not require any takes beyond a purchaser's demand.

The priority provisions of Rule 1-305 likewise do not increase the volume of gas that a purchaser must take. The priority provisions are purely designed to prevent underground waste and protect public safety by giving preference to hardship and distressed wells, enhanced recovery wells, and wells producing casinghead gas and associated gas. *See* discussion at pp. 7-8 of the Corporation Commission's certiorari petition. Because Rule 1-305 only operates in times of limited market demand, and because the Rule contemplates that a purchaser may shut-in lower-priority wells, the purchaser is not required to take more gas than its market demand requires. Unlike *Transco,* the interstate purchaser is not required to increase purchases. This demonstrates that Rule 1-305, in its very function and operation, is a *production* regulation.

The Tenth Circuit's decision in this case conflicts with the *Northwest Central* holding. Nowhere does the Tenth Circuit conduct the analysis contemplated by *Northwest Central* for determining whether a regulation is purchasing-oriented or production-oriented. Rule 1-305 is not a direct purchaser regulation. It is a *production* regulation utilizing purchasers as a necessary means to allocate production. The Corporation Commission's intent is unambiguous:

> The regulation of natural gas takes by interstate pipelines is an incident of the exercise of this Commission's jurisdiction over the regulation of the production of natural gas from a common source of supply. The exercise of this incidental jurisdiction is necessary in order to protect correlative rights and prevent waste.

Oklahoma Corporation Commission Order No. 281285, App. F at 66-67.

Rule 1-305 therefore falls within the "traditional powers [of the States] to regulate rates of production, conserve resources, and protect correlative rights." *Northwest Central,* slip op. at 19, 57 U.S.L.W. at 4308. The Tenth Circuit's opinion ignores the practical operation of Rule 1-305, and, in doing so, violates this Court's explicit warning that courts should not "by an extravagant . . . mode of interpretation push powers granted over transportation and rates so as to include production." *Northwest Central,* slip op. at 16, 57 U.S.L.W. at 4307 (ellipsis in original) (quoting *FPC v. Panhandle Eastern Pipe Line Co.,* 337 U.S. 498, 513-14 (1949)).

So that the Tenth Circuit may have an opportunity to reconsider its decision in light of *Northwest Central,* this Court should grant certiorari for the limited purpose of remand.

B. RULE 1-305 DOES NOT CONFLICT WITH FEDERAL LAW.

In *Northwest Central,* this Court held that production regulations inevitably influence purchasing practices and costs of interstate pipelines subject to federal regulation.

Id., slip op. at 19, 57 U.S.L.W. at 4308. "Thus, conflict-pre-emption analysis must be applied sensitively in this area, so as to prevent the diminution of the role Congress reserved to the States while at the same time preserving the federal role." *Id.*, slip op. at 20, 57 U.S.L.W. at 4308. As such, production regulations are preempted only if it is impossible to comply with both state and federal law; if the production regulation prevents attaining FERC goals; or if the production regulation has an impact on a federal matter and that impact is not incidental to a proper state purpose. *Id.*

In *Northwest Central,* this Court specifically found that the Kansas Corporation Commission regulation did not impede the attainment of any FERC goal, and, although impacting areas of federal control, the regulation was plausibly related to matters of legitimate state concern. *Northwest Central,* slip op. at 23-24, 57 U.S.L.W. at 4309.[1]

The same is true of Rule 1-305. First, Rule 1-305 does not impede attainment of FERC goals. The purpose of the NGPA is to assure adequate supplies of gas. A necessary component of assuring adequate supplies of gas is assuring that gas is produced without waste, whether that waste results from over-production or under-production. Gas wastefully left underground in unrecoverable pockets may never be used productively. Rule 1-305 is designed both to

[1] Neither in *Northwest Central* nor in this case was an argument made that it was impossible to comply with both federal and state regulations. Slip op. at 21, 57 U.S.L.W. at 4308.

protect correlative rights and to prevent wasteful production of all kinds. Furthermore, Rule 1-305 acts as an adjunct to the federal policy of allowing the free market to function to set gas prices. Rule 1-305 does this by defining property rights, which are indispensable to the unfettered and efficient functioning of the free market.

Second, although Rule 1-305 may impact on federal matters, it is not pre-empted because Oklahoma's purpose is "to regulate *production* . . . and the means chosen [is] at least plausibly . . . related to matters of legitimate state concern." *Northwest Central,* slip op. at 23-24, 57 U.S.L.W. at 4309. Rule 1-305 is a production regulation. Oklahoma's purpose in promulgating Rule 1-305 was to allocate production to existing market demand. Rule 1-305 is a method by which the Corporation Commission enforces that *production* allocation. It explicitly shows a "production and gathering" concern. Oklahoma's purpose is to regulate production, and the means chosen, Rule 1-305, is more than plausibly related to that matter of legitimate state concern. *See Northwest Central,* slip op. at 22-23, 57 U.S.L.W. at 4309.

The import of *Northwest Central* lies in the emphasis that this Court placed on determining whether a regulation was production related or purchasing related. If the regulation is designed to deal with production, then effects on interstate purchasers are nonetheless justified. The Tenth Circuit completely disregarded this vital issue in its opinion in this case. The Tenth Circuit leaped to the question of whether Rule 1-305 affected interstate purchasers. Concluding that the Rule did, the Tenth Circuit stopped short

its analysis and wholly neglected the *production* question, relegating it to a final footnote stating that the trial court gave no consideration to the power to regulate production. *ANR Pipeline Co.*, 860 F.2d at 1582 n.4.

The Tenth Circuit's decision in this case is in direct conflict with this Court's holdings in *Northwest Central.* Certiorari should thus be granted to correct that conflict. At minimum, this Court should grant certiorari and remand this case to the Tenth Circuit for reconsideration in light of the *Northwest Central* decision.

Respectfully submitted,

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